set transport and termination rates make a LEC indifferent to whether it terminates its own calls or passes them along to another carrier for termination.

49. The ***Notice*** incorporates by reference two additional arguments adopted in the ***ISP Remand Order***,[14] purporting to show why the hypothesized "ISP problem" cannot be solved by "getting the rates right," but these contentions are likewise not persuasive First, the ***ISP Remand Order*** observes that reciprocal compensation rates for ISP-bound traffic involve difficult "peak load pricing" issues. ***ISP Remand Order* ¶ 76** n. **147.** Just because peak-load pricing issues may be involved in this context (and again, we express no opinion on whether this **is** the case), cannot be a ground to reject CPNP because there is a well-developed economics literature on how to implement this standard. ***See,*** *e.g.*, Edgar K. Browning & Jacquelene M. Browning, MICROECONOMIC THEORY AND APPLICATION, Ch. **14 (1992);** Robert **S.** Pindyck & **Daniel L.** Rubinfeld, MICROECONOMICS, Ch. 11 **(1988).** Moreover, peak-load pricing issues would not disappear in a **B&K** regime. To the extent that regulatory commissions want to set efficient charges for recovery of termination costs under **B&K**, they would need to establish peak-load rate structures.

50. Likewise, the fact that state commissions may have mandated flat-rated pricing of end-user services in the face of usage sensitive call termination costs is irrelevant to the issue of whether there is "regulatory arbitrage" from CPNP or from **B&K**. Rather, it is relevant only to whether state commissions have adopted efficient rate design for end-user charges. And to the extent any such problem exists, it would also exist in a **B&K** regime. **A LEC** serving a customer that called an ISP would still incur usage sensitive costs for the originating end of the call even if it no longer-has to make usage sensitive payments to the terminating LEC serving the ISP. On the terminating side, moreover, a requirement of flat-rated charges in a B&K environment would affirmatively discourage carriers from serving ISPs, and to the extent incumbent LECs have "carrier of last resort" obligations, they would thus continue to incur per minute costs that they could not pass on to end-users in per minute charges.

51. Second, the ***ISP Remand Order*** states that "the fundamental problem with application of reciprocal compensation to ISP-bound traffic is that intercarrier payments fail altogether to account for a carrier's opportunity to recover costs from its ISP customer." ***ISP Remand Order*** ¶ ***36.*** The fact that the ISP is not directly paying for the costs of terminating a call would only be economically relevant if the ISP were the causer **of** those costs. As discussed above, it is not – the calling party is. Thus, whether the ISP can pass the costs of terminating a call along to its customers is beside the point because the calling party should bear the costs of the call. Further, CPNP has sufficient flexibility to allow an ISP to assume the costs of calls while recovering those costs in its subscriber charges. In particular, under CPNP (but not B&K) an **ISP** can establish a "800" number so that it bears all of the costs of calls to the ISP in conjunction with Internet access subscriber charges that reflect the fact that the ISP, rather than its subscribers, is paying the costs of calls to the ISP.

52. ***Terminating Access Monopolies.*** The ***Notice*** correctly identifies the "terminating access monopoly" problem that arises where a called party does not have an incentive to chose a LEC

(. . .continued)
[14] ***Intercarrier Compensation for ISP-Bound Traffic***, Order on Remand and Report and Order, FCC 01-131 (Apr. 27, 2001) (***"ISP Remand Order").***

that charges efficient terminating access charges, because the calling party's carrier, not the called party, pays the terminating carrier's termination charges. At the same time:

> an end user typically subscribes to only one **LEC.** Hence, other carriers seeking to deliver calls to that end user have no choice but to purchase terminating access fiom the called party's **LEC.** These originating carriers generally have little practical means of affecting the called party's choice of access provider.

***Notice* ¶ 13.**

53. We agree that this is a legitimate concern. ***See*** B. Douglas Bernheim and Robert Willig, ***The Scope of Competition in Telecommunications,*** American Enterprise Institute Studies in Telecommunications Deregulation (1996). To the extent that **a** carrier can unilaterally force other carriers to subsidize it through above-cost access or termination charges, marketplace distortions will follow. This problem is fully addressed, however, by setting cost-based termination and access rates. Under the competitive market model, the pertinent costs for purposes of determining reciprocal compensation and access charges are not an individual **LEC's** expenditures, but the forward-looking, economic costs of providing basic call termination. That means rates should be based on efficient network design, currently available technologies, and efficient management and operations. Rates that adhere to that standard fully protect originating carriers fiom supracompetitive charges and provide terminating **LECs** with powerful incentives to operate efficiently.

54. In contrast, the ***Notice's*** explanation **(**¶ 40) why a switch to B&K would solve the terminating access monopoly problem **is** based on the inapposite assumption that there is sufficient competition for end-users efficiently to constrain the charges LECs would assess end-users under B&K for terminating calls. **As** discussed above, incumbent **LECs** retain substantial market power, and thus, all that B&K would do is change the entity that must be protected fiom

LEC market power. It **is** insistence upon forward-looking, cost-based price caps that will solve the terminating access problem, not a switch from **CPNP** to **B&K**.

55. ***Price Squeezes.*** We cannot understand the ***Notice's*** apparent concern that **CPNP** promotes the ability of incumbent **LECs** to implement anticompetitive price squeezes against unaffiliated **IXCs**. ***Notice* ¶¶ 15,** 118. It **is *above-cost*** access rates that give the **LECs** the potential to implement an anticompetitive price squeeze. That is because the incumbent **LECs** with long distance authority can obtain access (from themselves) at economic cost, but charge their **IXC** competitors rates that are well above costs. ***See Local Competition Order* ¶ *635*** ("pricing above forward-looking economic costs would subject competitors to substantial risk of an anticompetitive price squeeze because the real cost of a network element for the incumbent **LEC** will be its forward-looking economic cost, while the cost to the new entrant will be the higher price charged for the element by the **LEC").** In these circumstances, the incumbent **LEC** may have the ability and incentive to charge a price for long distance that is below its rivals' costs, not due to relative efficiency, but in order to squeeze its rivals out of the market. However, the ability to price squeeze anticompetitively is eliminated if unaffiliated **IXCs** obtain access at the same economic cost as the incumbent. ***Id. See also Application of NYNEX Corp. and Bell Atlantic Corp. for Consent to Transfer Control of NYNEX Corp. and its Subsidiaries,*** Memorandum Op. and Order, **12 FCC Rcd 19985, ¶ 117 (1997); *Access Reform Order* ¶ 280.** That can be accomplished by setting access charges on the basis of forward-looking, economic costs.

56. **B&K** would in no way impede the ability of an incumbent **LEC** to engage in an anticompetitive price squeeze. Under **B&K**, a consumer would buy its originating access from its **LEC** and

intercity transport from an IXC. COBAK White Paper ¶ 38. If the above-cost access charges IXCs currently pay were simply transformed into end-user charges, nothing would alter the basic economics that currently allow LECs to price squeeze anticompetitively. The consumer's total price for "long distance" would be, as it is effectively today, the sum of the end-user "access" charge assessed by the LEC and the inter-city transport assessed by the TXC. **A** LEC that offers long distance, on the other hand, would continue to obtain access at economic cost and could offer a "bundled price for long distance that reflects its economic costs for access rather than the inflated costs the IXC pays. Because the consumer would still need to purchase access from the LEC in order to use the IXC's inter-city transport service, the fact that the access charge is paid by the consumer rather than the IXC (and passed along to the consumer) in no way impedes the ability of the LEC to set a price with a consumer appeal that the IXC cannot match, regardless of its relative efficiency.

57. B&K would, however, give incumbent LECs new weapons to advantage anticompetitively their long distance affiliates. Under B&K, IXCs would lose control of the end-to-end price of their long distance services. Currently, IXCs buy access services from incumbent LECs and then combine those inputs with intercity transport and offer consumers a single price for getting from the calling party to the called party. **As** noted, under B&K, IXCs would effectively sell only intercity transport while incumbent LECs would sell directly to end-users exchange access service (both on the originating and terminating side). COBAK White Paper ¶ 38. Thus, rather than offering an end-to-end service, IXCs would be selling to consumers an input that consumers would then combine with other inputs in order to "produce" an end-to-end long distance call.

58. Even if LEC access charges to end-users were appropriately capped, incumbent LECs would have both the incentive and the ability to adopt rate designs that would impede competition from their IXC rivals. For example, suppose that in a "B&K world," an IXC wanted to offer 3 cents a minute long distance 24 hours a day. Although the IXC could control the price of the intercity component, it would have no control over the rate design for the access service consumers would buy from the incumbent LECs. An incumbent LEC could refuse to offer a uniform 24 hour a day rate for access, thereby effectively preventing the IXC from offering a long distance service in which customers pay the same rate no matter when they call. Indeed, the IXC would not even be able to tell consumers in advance how much they would pay for a long distance call because the end-to-end price would depend upon (1) where the called and calling party live and what access rates the incumbent LECs serving those customers charges; (2) how those access rates vary, if at all, by time of day; (3) how those rates vary, if at ail, by volume.

59. In contrast, LECs would have much greater ability to offer an end-to-end price. Indeed, the mega-RBOCs – Verizon and SBC – would gain a huge competitive advantage because the majority of calls that originate in their regions also terminate there. Thus, these RBOCs would be able to control the price of all three components, *viz.* originating access, intercity transport, and terminating access, of most long distance calls made by their customers, and these RBOCs alone could offer a single price for long distance.

60. A switch to B&K, at least in the form proposed by Dr. DeGraba, would also increase the ability of LECs to engage in non-price discrimination against IXCs that compete with their long distance affiliates. Today, IXCs order, specify the capacity of, and pay for, the trunk groups

used to transport long distance traffiic from the LEC end offices to the IXCs' **POPs** (and ***vice versa).*** In contrast, under B&K, the originating and terminating LECs would determine what access facilities were deployed to the IXCs' POPs. Those LECs would have every incentive to favor their own long distance services by, for example, undersizing the trunks deployed to IXCs' POPs, or otherwise degrading service quality.

61. ***Inefficient Rate Design.*** The ***Notice*** observes **(¶ 17)** that "existing rules allow, and in some cases require, interconnection charges to be **set** on a traffic-sensitive basis . . . . If the underlying network costs are non-traffic sensitive, however, then these traffic sensitive retail rates will reduce network usage to inefficient **levels**." We agree, but this does not call into question the efficiency of cost-based intercarrier pricing. Rather, the ***Notice's*** statement of the problem makes clear what the answer is – usage sensitive terminating costs should be recovered in usage sensitive rates and non-traffic sensitive terminating costs should be recovered in non-traffic sensitive rates. **As** we understand them, the Commission's existing intercarrier reciprocal compensation rules already require this. And, as we noted above, ensuring efficient congruence between the ways costs are incurred and the ways they are recovered would likely be much more difficult in a B&K end-user charge regime (if only because of the political realities).

62. ***Impact on incumbent LEC network element rates.*** Cost-based intercarrier compensation for transport and termination rates provides a powerful incentive to incumbent LECs to moderate their unbundled network element ("UNE") rates for the same switching and transport functionalities. Many state commissions base reciprocal compensation rates on the switching and shared transport network element rates charged by incumbent **LECs**. Thus, if incumbent

LECs convince state commissions to set rates for these elements that are excessive, they invite regulatory arbitrage by competing carriers that will increase the incumbent LECs' reciprocal compensation payments to those other carriers. ***See*** AT&T ***exparte*** in CC Docket No. **99-68** (Aug. **14, 2000**). A switch to B&K would entirely eliminate this salutary benefit of the existing CPNP rule.

63. ***Other Problems.*** The specific B&K schemes discussed in the ***Notice*** raise additional regulatory issues. The COBAK rule, for example, would require the Commission to enact a series **of** regulations designed to determine precisely what constitutes a "central office" for purposes of the default POI interconnection rule. COBAK requires that "the calling party's network is responsible for the costs of transporting the call to the called party's central office." COBAK White Paper **¶ 24**. As the ***Notice*** observes **(¶ 103)**, this rule gives carriers "an incentive to claim that their central offices are as close to the end-user customer as possible." Incumbent LECs would have a particularly strong incentive to argue that remote switch modules or even remote digital loop carrier terminals – which, we understand, are being increasingly deployed by incumbent LECs – should be treated as a "central office" for purposes of the COBAK default rule. Treating these facilities as "central offices" would force competitive LECs to be responsible for the costs of transporting traffic further into the incumbent LECs' network, which both increases the interconnection costs of competitive LECs and lowers the incumbent LECs' termination costs.

64. Atkinson & Barnekov's "BASICS" proposal is even more problematic because it would raise significant entry barriers while at the same time it is not practical to implement. BASICS is a "general theoretical approach to intercarrier compensation" developed to deal with "various stylized models." ***Notice* ¶ *30*** n.46. Nonetheless, Atkinson & Barnekov advocate a specific rule that would govern interconnection between two telecommunications carriers. "Intra-network costs" would be recovered from end-users while the interconnected carriers would "divide equally the costs that result purely from interconnection." ***Id*** ¶ 25. "Intra-network costs" are defined as the costs of "handling all the possible traffic that [a carrier's] subscribers generate in making or receiving calls."

65. The proposed rule that the "incremental costs of interconnection" should arbitrarily be split 50-50 could create a new barrier to local telephone competition. To the extent that these interconnection-related costs are fixed (and Atkinson and Barnekov analysis is expressly premised on this assumption, ***see id* ¶ 28)**, competitive **LECs** have orders of magnitude fewer lines to spread these costs over than incumbents. Thus, incumbent **LECs** would have no incentive to minimize interconnection costs because increasing the total costs of interconnection disproportionately disadvantages their smaller rivals.

66. Moreover, we see no way in practice to determine "intra-network costs" as opposed to those costs that are "incremental" to interconnection. Although the ***Notice* (¶** 46) appears to treat the "incremental costs of interconnection" as only transport pieces that connect otherwise fully developed networks, that does not seem to follow from the logic of their proposal. In practice, the size of a particular carrier's network would depend upon whether it is interconnected with other networks. More specifically, the number of subscribers a particular network could attract, how frequently those subscribers would make calls, and how long those calls would be all

depend critically upon whether a carrier is interconnected to other carriers.[15] Further, there is generally no way to observe "intra-networks" directly because, to our knowledge, all new entrants build and size networks with the expectation of interconnecting to other carriers.

VII. THE COMMISSION'S EXISTING INTERCONNECTION RULES ARE EFFICIENT AND SHOULD BE MAINTAINED.

67. The ***Notice*** seeks comment on the efficiency of several specific interconnection rules and practices: (1) the rule that competitive carriers may determine where their networks will interconnect with incumbent carriers' networks; **(2)** the widespread practice of both competitive and incumbent carriers of assigning "NXX" codes associated with a local calling area to customers located outside that local calling area (also known as "virtual central office codes"); **(3)** the widespread practice of indirect interconnection, in which an incumbent **LEC** is compensated to deliver "transit" traffic over its ubiquitous network from **an** originating carrier that serves the calling party to the terminating carrier that serves the called party; and **(4)** the rule that a competitive carrier may charge higher "tandem" switching rates when it terminates calls from a switch in its single-layer switching architecture that serves a geographic area comparable to a tandem switch in the incumbent's legacy two-layer switching architecture. **As** we discuss below, these regulatory issues are largely independent of the choice between CPNP and B&K, and, in each case, the existing rule or practice better promotes efficiency and competitive neutrality than would the available alternatives.

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[15] For example, a competitive carrier that served only 10 customers and that was not interconnected to any other network would need a much smaller network (in terms of switching and transport capacity) than a network that served the same **10** customers, but was interconnected to an incumbent, thereby allowing its 10 customers to send and receive calls from a much larger subscriber base. The additional facilities that would be necessary to provide service in this latter case are, logically, "incremental" to interconnection. We see no way in which these costs can be accurately measured.

68. **Points Of Interconnection.** Few (if any) customers would be interested in purchasing local telephone service from a new entrant if that meant that they could not make and receive calls to and from each customer served by the incumbent provider. Moreover, absent regulation, an incumbent could erect potent barriers to entry even short of outright refusals to interconnect by, for example, insisting that competing providers interconnect at multiple, inconvenient points. Such anticompetitive acts would substantially raise potential rivals' costs by effectively requiring them to replicate the incumbent's ubiquitous interoffice network.[16] That is presumably why Congress placed on incumbent LECs the duty to interconnect with a requesting carrier "at any technically feasible point within the [incumbent's] network." 47 U.S.C. § 251(c)(2)(B).

69. The Commission implemented that obligation in its 1996 *Local Competition* Order. *See* 47 C.F.R. § 51.305. The Commission explained (¶ 209):

> Section 251(c)(2) gives competing carriers the right to deliver traffic terminating on an incumbent LEC's network at any technically feasible point on the network, rather than obligating such carriers to transport traffic to less convenient or efficient interconnection points. Section 251(c)(2) lowers barriers to competitive entry for carriers that have not deployed ubiquitous networks by permitting them to select the points in an incumbent LEC's network at which they wish to deliver traffic. Moreover, because competing carriers must usually compensate incumbent LECs for additional costs incurred by providing interconnection, competitors have an incentive to make economically efficient decisions about where to interconnect.

[16] Because they already have ubiquitous networks and an enormous scale advantage, incumbent LECs may experience less of an impact from an inefficient transport arrangement than do competitive LECs. Thus, incumbent LECs might very well prefer to force inefficient transport arrangements to raise significantly the competitive LECs' costs and thereby raise the minimum viable scale necessary for entry as well as the rates these competing carriers need to charge their customers.

70. We wholeheartedly agree. Indeed, because the Commission's existing rules require the originating carrier to compensate the terminating carrier at forward-looking economic costs – thereby divorcing compensation from the terminating carrier's actual expenditures – the existing "point of interconnection" (or "POI") rule does not distort ***either*** carrier's incentives to design and operate their networks efficiently.

71. It is important to recognize that identical incentives would exist under a B&K rule, and that the public policy assessment of this POI rule is thus entirely independent of the choice between CPNP and B&K.[17] Regardless of which convention the Commission applies, compensation would not be based in any way on either carrier's actual expenditures and thus both carriers would have incentives to minimize their own individual costs. That is not to say that both (or, indeed, either) of the carriers would necessarily have the incentive to minimize the ***overall*** costs of transport and choose the optimally efficient POI. Indeed, as noted above, incumbent LECs have strong incentives to establish inefficient interconnection points to raise their potential rivals' costs and deter competitive entry. The point is simply that the choice of B&K over CPNP (or ***vice versa)*** has no impact on those incentives. ***See Local Competition Order*** ¶ 1086 ("compensation rule gives the competing carrier correct incentives to minimize its own costs of termination because its termination revenues do not vary directly with changes in its own costs").

[17] Under CPNP, the POI marks the point at which the originating network must begin to pay the terminating party's network reciprocal compensation for terminating the phone call. Under B&K, the POI would mark the point at which each carrier would begin to bear its own costs for terminating another carrier's traffic and the point at which the carrier is no longer responsible for the costs of carrying traffic originated by one of its customers.

72. We understand that some incumbent **LECs** have complained that certain competitive **LECs** have, in some areas, chosen a POI for an area larger than the incumbent's existing local calling area. The incumbents claim that, in these situations, calls to or from the competitive **LEC's** subscribers may have to be transported many miles to and from the competitive **LEC's** distant switch even when the called and calling parties live near each other. The ***Notice*** seeks comment (**¶¶ 112-14)** on whether this practice suggests that the existing rule should be discarded.

73. We do not believe that it does. The existing rule reasonably balances the need to require the competitive carrier to internalize the costs caused by its interconnection point decisions with the need to ensure that the incumbent's enormous scale economies are not exploited to preclude competitive entry. Suppose, for example, that a competitive **LEC** established a single POI (for the purpose of handing off and receiving traffic) near Baltimore, Maryland, and that the competitive **LEC's** initial market entry was focused on Baltimore. If the competitive **LEC** wanted to expand its service to surrounding communities, the most efficient option for the competitive LEC likely would be to continue to use the Baltimore-based POI, at least until its volume of customers and traffic in the surrounding areas would support another POI. Importantly, the existing rules do not allow the competitive **LEC** to escape the financial consequences of that interconnection choice. Under the existing rules, the competitive **LEC** must bear all of the costs of transport on its side of the POI. The competitive **LEC** would therefore have to pay to transport every call made by one of its customers in the surrounding communities to the Baltimore **POI.**

74. The existing rules also require payment by the competitive **LEC** to the incumbent **LEC** for transport and termination from the POI to the incumbent central office serving the called party for all calls from the competitive **LEC's** customers to the incumbent's customers. **A** competitive **LEC** that chooses to interconnect at a single POI must therefore pay the incumbent to transport traffic from the POI to a serving office near the distant called parties. To the extent such charges are properly set at the forward-looking, economic cost of transporting the calls, the incumbent is appropriately compensated, and the competitive carrier bears the costs of the additional transportation. For these reasons, the competitive **LEC** itself would have an incentive, once its volume of distant customers increased sufficiently, to establish an additional POI or POIs closer to the more distant communities. In other words, if and when the traffic being transported to and from distant customers rises to significant levels, the competitive LEC would have the correct incentive to modify its single POI configuration, if such a modification is efficient.

75. Until such time, allowing the competitive **LEC** to choose a single POI makes it more likely that the new entrant can become a viable competitor. In this regard, we emphasize that incumbent local calling areas and network designs are not entitled to any presumption of efficiency. Moreover, any rule that unnecessarily increases competitive **LECs'** costs of growing their networks or fails to recognize that incumbent **LECs** have the advantage of scale could preclude local competition in many areas. Indeed, sound interconnection policy must reflect the current market realities whereby incumbent **LECs'** ubiquitous networks with enormous traffic flows must interconnect to nascent networks with limited market presence and volumes of traffic.

76. In any event, there are really only two alternatives to the current rule that the competing carrier chooses the point(s) of interconnection: (1) the Commission chooses, and (2) the incumbent carrier chooses. The "regulator's choice" option is unattractive because there is no one-size-fits all solution to interconnection point decisions. Interconnection points that may be efficient in a particular area for carriers with certain volumes of traffic may not be efficient in other areas or at other volumes of traffic. The existing rule recognizes this by allowing competitive LECs to tailor point of interconnection decisions to local conditions but requiring them to bear the economic consequences of those decisions.

77. Given the incumbents' incentives to game the interconnection point decision to protect their monopolies, the second alternative too is unacceptable. Indeed, this is vividly illustrated by the incumbent LEC interconnection proposals discussed in the ***Notice.*** The incumbent LECs seek to change the existing efficient rule and ask the Commission to require competitive LECs either to establish a separate POI in each "local calling area" or to pay for all the costs the incumbent LEC incurs in transporting calls to the "distant" POI when an incumbent LEC customer calls a competitive LEC customer. ***Notice*** ¶ 112. In other words, the incumbent LECs have argued that when a competitive LEC uses a "distant" **POI,** the incumbent LEC should be paid for transporting its own customers' calls to the POI and that the incumbent LEC should not have to pay reciprocal compensation for the termination of those calls. In effect, the incumbent LECs argue for **a** *called* party pays scheme when competitive LECs use a distant POI.

78. The incumbents' proposal would unnecessarily impede the ability of competitive LECs to compete on the merits. For the reasons discussed above, many competitive LECs enter local markets by deploying a single switch and then using fiber optic facilities to reach customers, who sometimes are relatively remote from the switch. This allows competitive LECs to address a much larger geographic base than are generally addressed by incumbent LEC switches. Allowing competitive LECs to establish only one POI per **LATA** facilitates this practice.

79. The incumbent LECs' argument is premised on the logical fallacy that their networks establish the efficiency "baseline" and that because competitive LECs employ a different architecture (one which uses fewer switches and longer loops), competitive LECs "cause" increased transportation costs. But one could argue, with equal plausibility, that the differences are "caused" by the incumbent LECs, because they chose to design their local networks differently from competitive LEC networks. In actuality, neither network should be viewed as the "baseline." Rather, it **is** the interconnection of ***both*** networks to one another that creates additional costs that neither would bear if interconnection was not required.

80. Therefore we believe the focus of this issue should be on the impact of the incumbent LECs' proposal on competition. This proposal seems to be biased and anticompetitive. The incumbent LECs' proposal would require competitive LECs to pay incumbent LECs for the "privilege" of having incumbent LECs carry ***their own traffic*** to the **POI** while precluding competitive LECs from collecting reciprocal compensation when terminating that traffic.

81. **Virtual Central Office Codes.** The ***Notice*** also seeks comment on use of "virtual" central office codes ("NXXs"). Virtual NXX codes are "central office codes that correspond with a particular geographic area that are assigned to a customer located in different geographic area." ***Notice*** ¶ 115 n. **188.**

82. We understand that there are sound business reasons for using virtual NXX codes. Many customers like virtual NXX codes because it allows them to be called "locally" by other end-users residing in a different calling area. Thus, virtual NXX codes are very useful for customers with high inbound traffic requirements that are originated over a broad geographic area, such as taxi dispatch services, radio station talk shows, and ISPs. In essence, virtual NXX codes allow competitive **LECs** to establish local calling areas that differ from the incumbent's legacy local calling area.

83. Although the incumbent **LECs** do not challenge the use of virtual NXX codes per *se*, they have advanced proposals that would effectively force competitive **LECs** to adhere to the incumbent **LECs'** local calling areas. **Id** ¶ 115. In particular, we understand that the incumbents have claimed that when one of their subscribers dials a number assigned to a competitive **LEC** customer that resides outside the local rate center, the call should be treated as a *toll* call, notwithstanding the fact that the call is rated to the calling party as a local call by virtue of the called party's virtual NXX code. Thus, the incumbents claim that such calls are not "local" so far as they are concerned and are, therefore, both subject to the incumbents' originating access charges and exempt from reciprocal compensation charges for transport and termination.

84. Again, the incumbent **LECs'** position is based on the logical fallacy that their local calling areas should define the local calling areas for their competitors. But there is no basis in economics or logic to treat the incumbents' local calling areas as establishing the efficient baseline local calling areas.

85. Instead, principles of efficiency and competitive neutrality dictate that the competitive **LECs** should not be forced to adopt incumbents' legacy calling areas. By basing the jurisdiction of a

call on the **NPA-NXX** of the calling and called numbers, incumbent LECs would pay reciprocal compensation when their customers call a competitive LEC customer with the same **NXX** code and ***vice-versa.*** But what would cease are attempts by incumbent LECs to force competitive LECs to pay above-cost access charges while at the same time avoiding paying competitive LECs for the costs of terminating traffic – costs that are caused by the incumbent LECs' customers.

86. In this regard, it is important to emphasize that requiring competitive LECs to incur above-cost access charges when providing local services to customers that are outside incumbent local calling areas would limit the ability of competitive LECs to compete on the merits by using a different network architecture. That would be neither efficient nor competitively neutral, particularly given that the incumbents can obtain access from themselves at economic cost.

87. **Transiting Traffic.** The ***Notice*** also seeks comment on "transiting" traffic. ***Notice*** **¶ 71. As** we understand it, "transiting" is the use by two competitive LECs of an incumbent LEC's facilities to transport traffic between them. This permits the competitive LECs to exchange traffic with each other while, at the same time, allowing these carriers to avoid having to construct dedicated facilities that would be necessary to link their networks directly. We understand that this arrangement is often used where the two competitive LECs do not exchange significant amounts of traffic.

88. To the extent that there **is** any question about whether existing Commission rules permit transiting, we believe that the Commission should expressly hold that incumbent LECs are required to transit competitive LEC traffic. Transiting lowers barriers to entry into the provision of local phone services. For the reasons just discussed, transiting gives competitive

LECs the option of using ubiquitous incumbent networks to interconnect with each other, and thereby, avoid the expenses and delays that would be incurred in the direct physical linking of their networks. This option also lowers the minimum viable scale for entry because the direct physical linking of networks can require significant fixed costs while competitive **LECs** incur transiting charges only to the extent they actually exchange traffic. **And** because incumbent **LECs** are fully compensated for transiting traffic, there can be no argument that incumbent **LECs** are being forced to subsidize competitive entry.

89. We also agree with Qwest that transiting is incompatible with B&K. ***Id.*** B&K contemplates that interconnected carriers recover their costs **from** end-users. But in the typical transiting situation, there is no end-user from which the "carrier in the middle" can recover costs. Just as principles of competitive neutrality would preclude the Commission from adopting rules that give incumbent **LECs** an unfair cost advantage, so too these principles preclude rules which require incumbent **LECs** to subsidize competitive carriers. Thus, if the Commission ultimately determines to adopt B&K to govern intercarrier compensation for local traffic, it should carve out an exception that permits the **LEC** that provides transiting services for other **LECs** to recover the forward-looking, economic costs of tandem switching used in providing this service.

90. **Tandem Rate Symmetry.** The ***Notice*** seeks comment on whether the Commission should retain its existing rule that the incumbent **LECs'** tandem interconnection rate should serve as a presumptive proxy to Competitive **LECs** who use new switch technologies "to serve a geographic area comparable to that served by the ILEC's tandem switch." ***Notice* ¶ 102.** The incumbent **LECs** claim that their costs should not serve as a proxy because competitive **LECs** have lower costs – by employing more modern switching equipment that can serve with a single switch a geographic region that an incumbent LEC can serve only be deploying both end office and tandem switches. What this argument principally proves, however, is that the incumbent LECs' own switching rates are too high. Properly set forward-looking switching rates should be capped at the forward-looking costs of the most efficient network architecture with currently available technology. Thus, to the extent that it is more efficient to use a single-layer network without tandems, incumbent LECs should not, as a matter of economics, be allowed to charge more simply because their own legacy network does include tandems.

91. That said, we recognize that the Commission's "scorched node" approach mandates, to some extent, deviation from the principle that forward-looking costs are to be based on efficient network design. ***See Local Competition Order* ¶ 685.** **Thus,** the issue **is** whether **an** incumbent LEC's tandem switching rates should be calculated by one pricing standard and a competitive LEC's by another. Competitive neutrality precludes any such an approach. **If** the incumbent LECs' "heads-we-win, tails-you-lose" standard were granted, incumbent LECs would earn above-cost reciprocal compensation on traffic they terminate while competitive LECs would earn only the efficient costs of terminating traffic. In effect, this is tantamount to requiring competitive LECs to subsidize their competitors. Such policy would be wrong-headed under any circumstances, but it is particularly so here in light of the nascent nature of the competitive LEC industry coupled with the enormous advantages incumbent LECs already enjoy.

92. Departing from rate symmetry would be particularly anticompetitive if the Commission were to accept incumbent LEC arguments that competitive LECs should be required to establish multiple interconnection points (such as at incumbent LEC end offices) rather than at a single point of interconnection. In those instances, competitive LECs would have to incur the additional costs of interconnecting at multiple points that are deeper in incumbent LEC networks. At the same time, incumbent LECs that interconnected at a competitive LEC switch could get the same geographic coverage as a tandem switch but only have to pay the end office switching rate.

93. More broadly, the Notice asks (¶ 106) whether forward-looking costs, given the incumbent LECs' switch placement (scorched node), should serve as a presumptive proxy for competitive LEC costs. Again, the answer is yes. To the extent that incumbent LEC rates are being set above long run incremental costs because of the Commission's decision to adopt "scorched node" rather than "scorched earth' forward-looking pricing, principles of competitive neutrality demand that competitive LEC reciprocal compensation rates be set using the same methodology as incumbent LEC reciprocal compensation rates.

VERIFICATION

I, JANUSZ A Orlaer, declare under penalty of perjury that the foregoing is true and correct. Executed on August 16, 2001.

VERIFICATION

I, Robert Willig, declare under penalty of perjury that the foregoing is true and correct. Executed on August 29 2001.

Robert Willig

Robert Willig

April 2000

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